

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED JUNE 30, 2008 AND 2007

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INDEPENDENT AUDITORS' REPORT



To the Board of Directors
Kansas Bioscience Authority
Olathe, Kansas

We have audited the accompanying balance sheets of the Kansas Bioscience Authority, a component unit of the state of Kansas, as of June 30, 2008 and 2007, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years ended June 30, 2008 and 2007. These financial statements are the responsibility of the authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Kansas Bioscience Authority as of June 30, 2008 and 2007, and changes in its financial position and its cash flows for the years ended June 30, 2008 and 2007, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 6, 2008, on our consideration of the Kansas Bioscience Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis as listed on the table of contents is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statement taken as a whole.

Allen, Gibbs & Houlik, L.C.
Allen, Gibbs & Houlik, L.C.
October 6, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

Years Ended June 30, 2008 and 2007

This annual financial report of the Kansas Bioscience Authority (KBA) consists of two sections: management's discussion and analysis (MD&A) and basic financial statements. This section of the report presents MD&A of financial position and changes in financial position for the years ended June 30, 2008 and 2007 and from the date of the authority's inception (April 2004) through June 30, 2006. This information is being presented to provide additional information regarding the activities of the KBA and to meet the disclosure requirements of Government Accounting Standards Board Statement No. 34, *Basic Financial Statements, and Management's Discussion and Analysis for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*.

The KBA is a self-supporting entity and follows enterprise fund reporting; accordingly, the financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. This analysis should be read in conjunction with the independent auditors' report, audited financial statements, and accompanying notes.



Janice Katterhenry, CFO

FINANCIAL HIGHLIGHTS

- The authority has initiated the programs called for under its enabling statutes as well as other initiatives aimed at advancing Kansas' national leadership in the biosciences. The authority has received the financial resources over the past fiscal years to fund the programs. The funds available to commit to the approved programs grew to \$65.0 million at June 30, 2008 from \$40.9 million at June 30, 2007 and \$19.3 million at June 30, 2006.
- Since the KBA's inception, its board of directors committed \$53.9 million through June 30, 2008. The authority's board committed \$29 million in fiscal year 2008 to companies and institutions to promote bioscience growth in Kansas. Most commitments are paid upon the achievement of milestones; at June 30, 2008 the total amount remaining to be paid on these commitments was \$37.7 million. Subsequent to June 30, 2008 through September 30, 2008 the authority's board approved additional commitments totaling \$13.8 million.
- Assets other than cash and securities, capital assets and the receivable from the state of Kansas increased in fiscal year 2008 by approximately \$10.6 million. The increase was a result of valuing land donated to the KBA for development of the Kansas Bioscience Park in Olathe, an equity investment and several convertible note investments in companies. Also, notes receivable increased by \$1 million. In fiscal year 2007 that same group of assets increased \$1 million as a result of issuing a note.
- Revenues are mainly derived from transfers from the state through the funding mechanism provided by the Emerging Industry Investment Act (EIIA). Revenues increased 47% or \$12.3 million in fiscal year 2008 and 5.7% or \$1.4 million in fiscal year 2007. These increases are a result of the increase in payroll withholding taxes each year in the bioscience sector.
- In fiscal year 2008, the authority granted \$5 million and invested \$4.6 million in companies in the form of equity or convertibles notes. The authority also provided an additional \$1 million to a company in the form of a note. The total paid in fiscal year 2008 was \$12.2 million compared to \$3.8 million in fiscal year 2007 and \$170,047 for the period ending June 30, 2006.
- The authority's fiscal year 2008 operating expenses other than grants and awards were \$2.3 million compared to \$1 million for fiscal year 2007 and \$.8 million for the period ending June 30, 2006. The increase in fiscal year 2008 was mainly the result of increasing staff, consulting fees, legal fees and marketing expenses related to implementing the KBA programs, documenting the investments and setting up the operational processes of the authority. The increase in fiscal year 2007 operating expenses was mainly the result of the initial hiring of staff and a decrease in office services and consultants.

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

Years Ended June 30, 2008 and 2007

OVERVIEW OF THE FINANCIAL STATEMENTS

The *balance sheet* answers the question, "How is our financial health at the end of the year?" This statement includes all assets and liabilities of the KBA, both financial and capital, short-term and long-term, using the accrual basis of accounting and economic resources measurement focus, which is similar to the accounting used by most private-sector companies. The resulting net assets presented in the statement are displayed as restricted or unrestricted. Assets are restricted when their use is subject to external limits such as legal agreements or statutes. Assets falling outside this category are characterized as unrestricted. Over time, changes in net assets may serve as a useful indicator of whether the financial position of the authority is improving or deteriorating.

All of the current year's revenues and expenses of the KBA are accounted for in the *statement of revenues, expenses, and changes in net assets*. This statement measures the activities of the authority's operations over the past year and presents the excess of revenues over expenses and change in net assets. It can be used to determine whether the KBA has successfully recovered all of its costs through loans, externally funded programs, and other revenue sources. This statement helps answer the question, "Is the authority as a whole better off or worse off as a result of the year's activities?"

The primary purpose of the *statement of cash flows* is to provide information about the sources and uses of the authority's cash and the change in cash balance during the reporting period. This statement reports cash receipts, cash payments, and net changes resulting from operating, non-capital financing, capital financing, and investing activities. It provides answers to such questions as where cash came from, what cash was used for, and what the change in cash balance was during the reporting period.

The *notes to the financial statements* provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements follow the basic financial statements.

CONDENSED FINANCIAL INFORMATION

Balance Sheet

The following table presents a condensed balance sheet at June 30:

	2008	2007	2006
Assets			
Cash and securities	\$65,029,128	\$40,920,801	\$19,259,534
Receivable from State of Kansas	8,852,271	6,355,062	4,747,642
Capital assets	382,963	94,687	—
Other assets	11,596,779	1,024,771	7,000
Total assets	<u>\$85,861,141</u>	<u>\$48,395,321</u>	<u>\$24,014,176</u>
Liabilities			
Current liabilities	\$ 1,075,169	\$ 647,396	\$ 22,085
Total liabilities	<u>1,075,169</u>	<u>647,396</u>	<u>22,085</u>
Net assets			
Invested in capital assets	382,963	94,687	—
Restricted for development	4,998,871	—	—
Unrestricted	79,404,138	47,653,238	23,992,091
Total net assets	<u>84,785,972</u>	<u>47,747,925</u>	<u>23,992,091</u>
Total liabilities and net assets	<u>\$85,861,141</u>	<u>\$48,395,321</u>	<u>\$24,014,176</u>

Statement of Revenues, Expenses, and Changes in Net Assets

The following table presents a condensed statement of revenues, expenses, and changes in net assets:

	2008	2007	2006
Revenues			
Operating revenues	\$ 92,708	\$ 13,060	\$ —
Transfers from State of Kansas	38,388,887	26,122,392	24,721,619
Contributed land	5,253,107	—	—
Investment income	2,286,771	1,352,392	278,091
Total revenues	<u>46,021,473</u>	<u>27,487,844</u>	<u>24,999,710</u>
Expenses			
Grants and awards	6,679,276	2,780,612	170,047
Other	2,304,150	951,398	837,572
Total operating expenses	<u>8,983,426</u>	<u>3,732,010</u>	<u>1,007,619</u>
Excess of revenues over expenses	37,038,047	23,755,834	23,992,091
Total net assets, beginning of period	47,747,925	23,992,091	—
Total net assets, end of period	<u>\$84,785,972</u>	<u>\$47,747,925</u>	<u>\$23,992,091</u>

Assets, liabilities and changes in net assets:

The authority's net assets grew to \$84.8 million at June 2008, an increase of \$37 million from June 2007. The growth in net assets resulted primarily from the transfers received from the state of Kansas via the Emerging Industry Investment Act. The increase in transfers was a result of job growth in bioscience companies from April 2004 through June 2008 over the base year of 2003. The net assets also were reduced by operating expenses. See the financial highlights on page 3 for additional information.

The KBA expended funds of \$4.6 million for portfolio investments in fiscal year 2008 compared to \$1 million in fiscal year 2007. The KBA's portfolio investments included two convertible notes and an equity investment. The KBA also provided an additional \$1 million in a note to a company.

CAPITAL ASSET ACTIVITY

Capital assets include furniture, office and computer equipment purchased in fiscal 2008 and 2007. In addition, KBA received donated land with an estimated fair value of \$254,236 from the city of Olathe for the construction of the KBA's incubator within the Kansas Bioscience Park. See additional information in note 9 to the financial statements.

ECONOMIC FACTORS

The authority's board approved guidelines and programs in the last quarter of fiscal 2007 intended to provide clear and concise description of the programs set forth by the legislature when it approved the Kansas Economic Growth Act in 2004. These program guidelines set forth the priorities which are to expand the state's bioscience R&D enterprise, commercialize bioscience discoveries, and provide for the research infrastructure necessary to expand the bioscience industry in Kansas. Some of the programs approved are the Eminent Scholars, Rising Stars, Matching Fund, Research and Development Vouchers, Expansion and Attraction, Bioscience Tax Investment Incentives, and Heartland BioVentures. A brief description of these programs is provided in the footnotes (pages 10 and 11). The funds committed to date would be broken down by program as follows:

Program:	Fiscal 2008	Inception through Fiscal 2008
Expansion and Attraction	\$ 5,250,000	\$11,197,388
Research and Development	14,954,954	15,204,954
Commercialization	8,704,170	27,154,361
Other	100,000	326,200
Total	<u>\$29,009,124</u>	<u>\$53,882,903</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

Years Ended June 30, 2008 and 2007

The research and development category includes \$8 million committed to the Eminent Scholar program, which is designed to recruit distinguished bioscience researchers to conduct their research and commercialization activities at Kansas research institutions. The \$8 million commitment, which will be paid out over several years, was made to eminent scholars at Kansas State University, the University of Kansas and Wichita State University. Also included in this category are \$2.5 million commitments to the Collaborative Biosecurity Research Initiative and the Collaborative Cancer Research Initiative. The Collaborative Biosecurity Research Initiative is designed to bring together researchers nationwide to create products in Kansas that protect Americans from animal-borne diseases that infect humans or disrupt the national economy, while the Collaborative Cancer Research Initiative is designed to introduce investigators outside of Kansas to the basic and clinical research, drug discovery, drug delivery, and drug development capabilities and facilities for cancer research in the state.

The commercialization category includes commitments related to infrastructure development and installation, equity investment, development of centers of innovation, Heartland BioVentures, and matching of federal and other research awards. Significant infrastructure commitments include \$7.6 million for a bioscience park in Olathe, Kansas; \$2 million for a wet lab incubator at the University of Kansas Medical Center; and \$1 million for a wet lab incubator in Manhattan, Kansas.

The city of Olathe conveyed approximately 54 acres of land to the Kansas Bioscience Authority to create the Kansas Bioscience Park. The purpose of the park is to assist in developing specialized infrastructure to facilitate the growth and expansion of bioscience companies. A benefit district has been created by Olathe to build the infrastructure at the park, and construction commenced in August 2008.

Investment in equity and convertible notes was a major KBA focus in fiscal year 2008. A \$650,000 equity investment was made in Innovia Medical, LLC to fund the commercialization of its EarCheck product, which utilizes the only technology for the rapid detection of middle ear fluid, a key indication of ear infections. Convertible note investment commitments totaling \$4.3 million were made to Ventria Bioscience, ImmunoGenetix Therapeutics and KC BioMediX to fund their efforts in the area of drug discovery, development and delivery.

Increasing the quantity of high-quality research performed in Kansas is the goal of the Kansas Bioscience Centers of Innovation. Through this program, Kansas can address its dual need to build strong, world-class bioscience research centers in its research institutions and to assist existing and emerging bioscience industries in capturing new knowledge and research findings for their product and production functions. The board approved \$1 million toward planning grants of up to \$200,000, and in fiscal year 2008 it awarded grants to fund the planning of the Kansas Center for Biomaterials Innovation and Design, the Kansas Bioscience Innovation Center in Drug Delivery, and the Kansas Innovation Center for Advanced Plant Design.

The board approved \$4.6 million to establish Heartland BioVentures with the goal of improving companies' access to venture capital. The program provides assistance and pre-venture financing to early stage bioscience firms to fundamentally address business, technology, management and other strategic issues critical to their success and, thus, improve their access to venture capital. The services, resources and networks of Heartland BioVentures and its partners are being directed to help bioscience startups develop products, raise capital and go to market.

The KBA has established a tracking and monitoring system to ensure milestone compliance for each of its investments, as well as to track outcome metrics. As the programs and projects mentioned above are funded they will be monitored and progress will be reported.

The authority has established a base of assets to invest in its mission of attracting bioscience entities that will increase employment, encourage research and development, commercialize bioscience discoveries, and provide for the research infrastructure necessary to expand the bioscience industry in Kansas. The ability to continue to invest in the KBA's mission is dependent on the growth of bioscience companies' payrolls.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide stakeholders in the KBA with a general overview of the authority's finances and to show the authority's accountability for the resources it receives, invests, and expends. If you have questions about this report, or need additional financial information, please contact Ms. Janice Katterhenry, CFO, at Kansas Bioscience Authority, 25501 W. Valley Pkwy, Ste 100, Olathe, KS 66061.

BALANCE SHEETS

June 30, 2008 and 2007

ASSETS

	2008	2007
Current Assets		
Cash and cash equivalents	\$ 2,578,188	\$ 1,063,302
Investments in securities	9,000,972	8,019,851
Receivable from State of Kansas	8,852,271	6,355,062
Accrued interest receivable	737,843	393,672
Prepaid expenses	36,156	12,204
Total current assets	21,205,430	15,844,091
Other Assets		
Deposits	4,500	4,500
Investments in securities	52,712,125	31,443,976
Portfolio investments	4,466,870	-
Note receivable	2,090,382	1,008,067
Land held for development	4,998,871	-
Capital assets:		
Land	254,236	-
Other capital assets, net	128,727	94,687
Total other assets	64,655,711	32,551,230
Total assets	\$85,861,141	\$48,395,321

LIABILITIES AND NET ASSETS

Current Liabilities		
Accounts payable	\$ 1,012,206	\$ 621,198
Payroll liabilities payable	23,624	18,617
Compensated absences	39,339	7,581
Total current liabilities	1,075,169	647,396
Total liabilities	1,075,169	647,396
Commitments (see Note 7)		
Net Assets		
Invested in capital assets	382,963	94,687
Restricted for development	4,998,871	-
Unrestricted	79,404,138	47,653,238
Total net assets	84,785,972	47,747,925
Total liabilities and net assets	\$85,861,141	\$48,395,321

The accompanying notes are an integral part of the financial statements.

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Years Ended June 30, 2008 and June 30, 2007

	2008	2007
Operating revenues:		
Interest income	\$ 92,708	\$ 13,060
Total operating revenues	<u>92,708</u>	<u>13,060</u>
Operating expenses:		
Grants and awards	6,679,276	2,780,612
Wages and benefits	1,053,834	316,139
Board fees and reimbursed expense	52,286	31,384
Meeting and travel expenses	95,502	41,608
Depreciation and amortization	36,803	10,075
Dues and subscriptions	9,885	10,058
Insurance	29,236	13,904
Contractual and consulting services	279,391	146,805
Legal services	391,268	159,338
Marketing	136,759	26,473
Office expense	68,791	67,118
Office services	–	88,915
Rent	51,878	39,581
Equity in loss of investee	98,517	–
Total operating expenses	<u>8,983,426</u>	<u>3,732,010</u>
Operating loss	(8,890,718)	(3,718,950)
Nonoperating revenues and expenses:		
Transfers from the State of Kansas –		
Emerging Industry Investment Act	38,388,887	26,122,392
Contributed land	5,253,107	–
Investment income	2,286,771	1,352,392
Total nonoperating revenues	<u>45,928,765</u>	<u>27,474,784</u>
Excess of revenues over expenses	37,038,047	23,755,834
Net assets, beginning of period	47,747,925	23,992,091
Net assets, end of period	<u>\$84,785,972</u>	<u>\$47,747,925</u>

The accompanying notes are an integral part of the financial statements.

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2008 and June 30, 2007

	2008	2007
Cash flows from operating activities:		
Cash received from others	\$ -	\$ 6,000
Cash paid to others	(9,454,528)	(4,107,335)
Net cash from operating activities	<u>(9,454,528)</u>	<u>(4,101,335)</u>
Cash flows from capital and related financing activities:		
Purchase of property and equipment	(65,593)	(104,762)
Net cash from capital and related financing activities	<u>(65,593)</u>	<u>(104,762)</u>
Cash flows from noncapital financing activities:		
Cash received from State of Kansas	35,891,678	24,514,972
Net cash from noncapital financing activities	<u>35,891,678</u>	<u>24,514,972</u>
Cash flows from investing activities:		
Purchases of investments in securities	(22,249,270)	(21,033,722)
Purchases of portfolio investments	(4,550,000)	-
Investment income	1,942,599	1,035,702
Net cash from investing activities	<u>(24,856,671)</u>	<u>(19,998,020)</u>
Net change in cash	1,514,886	310,855
Cash and cash equivalents at beginning of year	1,063,302	752,447
Cash and cash equivalents at end of period	<u>\$ 2,578,188</u>	<u>\$ 1,063,302</u>
Reconciliation of operating loss to net cash from operating activities:		
Operating loss	\$ (8,890,718)	\$ (3,718,950)
Adjustments to reconcile operating loss to net cash from operating activities:		
Depreciation	31,553	10,075
Equity in loss of investee	98,517	-
Changes in assets and liabilities:		
Prepaid expenses and deposits	(23,952)	(9,704)
Accrued interest	(92,708)	-
Notes receivable	(1,004,993)	(1,008,067)
Accounts payable	391,008	599,113
Payroll liabilities and compensated absences	36,765	26,198
Net cash from operating activities	<u>\$ (9,454,528)</u>	<u>\$ (4,101,335)</u>
Supplemental schedule of non-cash investing and financing activities:		
Contribution of land	\$ 5,253,107	\$ -

The accompanying notes are an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

NOTE I – REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Kansas Bioscience Authority (KBA) is an independent instrumentality of the state of Kansas. Its enabling statutes are found in K.S.A. 74-99b01 et seq. as amended and supplemented. The authority was created on April 19, 2004, with the passage of the Kansas Economic Growth Act (KEGA), a comprehensive economic development act designed to meet the needs of the changing Kansas economy. The authority was created to make Kansas the most desirable state in which to conduct, facilitate, support, fund and perform bioscience research, development of commercialization, to make Kansas a national leader in bioscience, and to create jobs, foster economic growth, advance scientific knowledge and improve the quality of life for the citizens of the state of Kansas.

Accounting principles generally accepted in the United States of America require that the reporting entity include: (1) the primary government, (2) organizations for which the government is financially accountable, and (3) other organizations for which the nature and significance of their relationship with the primary government are such that the exclusion would cause the reporting entity's financial statements to be misleading. The KBA is financially accountable to the state and the state exercises oversight responsibility on financial interdependency and selection of governing board members. The state has the ability to significantly influence operations and accountability for fiscal matters, special financing relationships, and scope of public service. The authority is included in the state's financial reporting entity, and the authority's transactions are reported in the state's Comprehensive Annual Financial Report as a component unit.

KEGA provided a funding mechanism through the Emerging Industry Investment Act based on the growth of state withholding taxes payable from employees of bioscience-related companies. State taxes that exceed the base year measurement of such taxes accrue to the authority for investment. This mechanism makes it unnecessary to raise taxes or reallocate amounts from other state budgets. Revenues that accrue belong exclusively to the KBA and are not part of the state treasury.

Some of the programs that the KBA will use in its investment in the biosciences are:

- **Matching Fund Program:** Matches research dollars from federal, private and other sources of support expanding the state's ability to attract federal research dollars.
- **Research and Development Voucher Program:** Provides funding to Kansas bioscience companies, in partnership with a Kansas research university, company, or institution, for proof-of-concept research and development activities and ancillary activities necessary to commercialize bioscience technologies. This program is designed to provide early stage financing and commercialization support for high-potential but high-risk innovations.
- **Bioscience Tax Investment Incentive Program:** Allows direct payment to a bioscience company in the amount of 50% of its Kansas net operating loss, up to \$1 million annually. Useful for business attraction or retention activities.
- **Eminent Scholars Program:** Designed to recruit distinguished bioscience researchers to conduct their research and commercialization activities at Kansas research institutions. An eminent scholar is an individual acknowledged as a scholar of distinction by national measures. The program will enhance the national eminence of selected outstanding academic research programs in the biosciences at Kansas universities and make important, direct contributions to Kansas capabilities for research and innovation in the biosciences.
- **Rising Stars Program:** Will retain and advance Kansas' best and brightest bioscience scholars. A rising star must be a researcher with a proven track record of grant productivity and team leadership in a research environment; researcher must demonstrate an interest in applying research to commercial opportunities that build Kansas' bioscience economy and most likely be a candidate for the National Academy of Science.

- **Expansion and Attraction Program:** Will create, retain and expand bioscience job opportunities for all Kansans. The program will facilitate the expansion and attraction of bioscience companies with strong growth potential and the ability to add high-quality jobs, develop or recruit bioscience researchers, and partner with Kansas research institutions.
- **Heartland BioVentures:** Is a business assistance program of the KBA designed to facilitate risk capital investment in Kansas bioscience companies. The goal is to provide to early-stage bioscience firms the assistance they need to fundamentally address business, technology, management and other strategic issues critical to their success, thus improving their access to venture capital. By selectively investing time as well as technical and business development expertise into emerging bioscience concepts, companies and entrepreneurs, BioVentures will be a source of pre-qualified deal flow for private venture investors interested in deals with reduced risk, and will provide clarity in the commercialization pathway.
- **Centers of Innovation:** Addresses the dual needs of building strong, world-class bioscience research centers in higher education and private research organizations and assisting existing and emerging bioscience industries in capturing new knowledge and research findings for their product and production functions.

Basis of Accounting

The KBA is organized as a proprietary activity. Transactions are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of this fund are included on the balance sheet. The operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets. The accrual basis of accounting is utilized. Under this basis of accounting, revenues are recognized when earned and expenses are recognized when the liability is incurred.

The authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with an entity's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

As required by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the KBA has elected to apply all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless FASB and/or APB pronouncements conflict with or contradict GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the authority's cash equivalents are defined as short-term highly liquid investments that are readily convertible to cash with an original maturity of three months or less.

Investments in Securities

Investments in securities are reported at fair value. As of June 30, 2008 and 2007, investments consist of funds invested in municipal securities and various government agency obligations. The fair value of these investments may fluctuate subsequent to year-end due to changes in economic conditions.

NOTES TO THE FINANCIAL STATEMENTS, CONTINUED

Portfolio Investments

Direct debt and equity financing which is extended to various companies to further the KBA's mission to advance the bioscience industry in Kansas are classified separately from investments in securities. These investments are usually reserved for projects where conventional lending is not an option due to large up-front investments with returns which may occur in future periods. Portfolio investments typically have no readily determinable fair value, and are initially recorded using the cost method of accounting. Under the cost method, investments are recorded at cost, adjusted for other-than-temporary impairment. Investments in certain limited liability companies are accounted for using the equity method, with an adjustment to the KBA's investment account for its proportionate share of income or loss from the investee. Dividends are treated as a reduction of the investment account upon receipt.

Portfolio investments recorded at cost which have experienced an other-than-temporary decline in value are written down to estimated fair value, establishing a new cost basis, with the amount of the write-down included in expense as a loss. The determination of fair value requires the use of estimates, which are based on information provided by the companies and knowledge of events or changes in circumstances that would have a significant impact on the value of the investment. Due to the inherent uncertainty in the use of estimates, fair values for purposes of evaluating impairment may differ significantly from the amounts ultimately realized from the investments or values that would have been used had a ready market for the investments existed, and the differences could be material.

Land Held for Development

Land held for development consists of the estimated fair value of land donated to the KBA for its use in attracting and developing future bioscience investment in Kansas.

Capital Assets

Capital assets are carried at historical cost less depreciation or amortization. Donated capital assets are valued at their estimated fair value on the date donated. Individual items with an initial cost of more than \$1,000 are capitalized. Major renewals and betterments are capitalized, and maintenance and repairs, which do not improve or extend the life of the respective assets, are charged against earnings in the current period. Depreciation and amortization are provided on the straight-line method over estimated useful lives ranging from 3 to 15 years.

Revenue Recognition and Receivables

Revenues generated under the Emerging Industry Investment Act from state withholding taxes as described under "Reporting Entity" above are considered voluntary nonexchange transactions to the authority. As such, revenue is recognized by the authority in the time period in which the withholdings are collected by the state. Receivables consist of amounts owed to the authority from the state of Kansas. Given the nature of the receivables, no amounts are considered uncollectible by management.

Net Assets

Net assets are classified as follows:

Unrestricted – consist of those operating funds over which the board of directors retains full control to use in achieving any of its authorized purposes.

Invested in capital assets – represents the authority's total investment in capital assets.

Restricted for development – includes land held for development, which is restricted by contractual agreement.

Revenues and Expenses

Revenues are classified as operating or nonoperating according to the following criteria:

Operating revenues – include activities that have the characteristics of an exchange transaction.

Nonoperating revenues – include activities that have the characteristics of non-exchange transactions such as grant award and tax revenues that are defined as non-operating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Non-expendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB Statement No. 34.

Expenses are classified as operating or nonoperating according to the following criteria:

Operating Expenses – include activities that have the characteristics of an exchange transaction such as a) employee salaries, benefits, and related expenses; b) supplies and other services; c) professional fees; and d) depreciation expenses related to capital assets.

Nonoperating Expenses – include activities that have the characteristics of non-exchange transactions such as grant award expenses, plus expenses not meeting the above definition for operating expenses.

Income Taxes

The authority is exempt from all federal, state, and local income, sales and property taxes.

Reclassifications

Certain amounts on the statement of revenues, expenses and changes in net assets for the year ended June 30, 2007, have been reclassified, with no effect on the change in net assets, to be consistent with the classifications adopted for the year ended June 30, 2008.

NOTE 2 – CASH AND INVESTMENTS

As of June 30, 2008 and 2007, the KBA had balances of \$2,578,188 and \$1,063,302, respectively, of cash and money market investments.

Deposit and Investment Policies. The authority has adopted deposit and investment policies. Investment guidelines were followed by the local investment company which holds the KBA's cash and investments. Such guidelines are discussed in more detail below.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the authority will not be able to recover the value of its deposits or investments that are in the possession of an outside party. At June 30, 2008 and 2007, \$75,746 and \$48,798, respectively, were exposed to custodial credit risk as deposits are in excess of FDIC insurance coverage limits. Subsequent to June 30, 2008, the KBA implemented a sweep option for its cash deposit account that transfers funds in excess of FDIC insurance coverage limits into a money market fund account for investment in government-backed securities. The investments in this money market account are protected from custodial credit risk by \$500,000 in Securities Investor Protection Corporation (SIPC) insurance coverage. Also, as of June 30, 2008 and 2007, underlying securities of \$61,713,097 and \$39,463,827 on investments were held by the investment's counterparty.

Credit Risk. As of June 30, 2008, the authority was invested in government agency securities including FHMLC, FFCB, FHLB, and FNMA securities. The government agency securities were rated AAA by Standard & Poor's and Aaa by Moody's Investors Service. Under the authority's investment policy, only AAA-rated securities were considered for investment.

NOTES TO THE FINANCIAL STATEMENTS, CONTINUED

Concentration of Credit Risk. Under the authority's investment policy, there is no limit on the total amount that can be invested in U.S. Treasury securities, government agency securities, or money market funds.

As of June 30, 2008, more than 5% of the KBA's investments are held in the following securities: FHLB (55%), FHLMC (22%), FNMA (13%), and FFCB (6%).

Interest Rate Risk. Interest rate risk relates to the exposure to fair value losses arising from the fluctuations in interest rates. Under the authority's investment policy, no less than 80% of the investment portfolio is limited to a maximum maturity of five years, with at least 20%, but no more than 80%, maturing in a two-year period. Also, no more than 20% of the investments may have a maximum maturity up to eight years. As of June 30, the authority had the following investment maturities:

Investment Type	June 30, 2008				
	Fair Value	Less than 90 days	90 days – 1 year	1 – 5 years	5 – 10 years
Government Securities	\$61,713,097	\$9,000,972	\$ –	\$48,112,471	\$4,599,654
Total	<u>\$61,713,097</u>	<u>\$9,000,972</u>	<u>\$ –</u>	<u>\$48,112,471</u>	<u>\$4,599,654</u>
Investment Type	June 30, 2007				
	Fair Value	Less than 90 days	90 days – 1 year	1 – 5 years	5 – 10 years
Municipal Securities	\$ 900,000	\$ 900,000	\$ –	\$ –	\$ –
Government Securities	38,563,827	1,566,543	5,553,308	31,443,976	–
Total	<u>\$39,463,827</u>	<u>\$2,466,543</u>	<u>\$5,553,308</u>	<u>\$31,443,976</u>	<u>\$ –</u>

NOTE 3 – PORTFOLIO INVESTMENTS

Investments consisted of the following at June 30, 2008:

Debt securities:	
Ventria Bioscience	\$3,752,466
KC BioMediX, Inc.	162,921
Equity securities:	
Innovia Medical, LLC	551,483
	<u>\$4,466,870</u>

At June 30, 2008, the KBA also owned warrants in one portfolio company to purchase 350,000 shares of common stock at an exercise price of \$1.30 per share.

NOTE 4 – CAPITAL ASSETS

Capital asset activity for the years ended June 30, was as follows:

	July 1, 2007 Balance	Increases	Decreases	June 30, 2008 Balance
Capital assets not being depreciated:				
Land	\$ –	\$ 254,236	\$ –	\$ 254,236
Total capital assets not being depreciated	–	254,236	–	254,236
Furniture and equipment	99,262	65,593	–	164,855
Leasehold improvements	5,500	–	–	5,500
Total capital assets being depreciated	104,762	65,593	–	170,355
Less accumulated depreciation:				
Furniture and equipment	(9,800)	(31,186)	–	(40,986)
Leasehold improvements	(275)	(367)	–	(642)
Total accumulated depreciation	(10,075)	(31,553)	–	(41,628)
Total capital assets being depreciated, net	94,687	34,040	–	128,727
Total capital assets, net	\$ 94,687	\$ 288,276	\$ –	\$ 382,963
	July 1, 2006 Balance	Increases	Decreases	June 30, 2007 Balance
Furniture and equipment	\$ –	\$ 99,262	\$ –	\$ 99,262
Leasehold improvements	–	5,500	–	5,500
Total capital assets being depreciated	–	104,762	–	104,762
Less accumulated depreciation:				
Furniture and equipment	–	(9,800)	–	(9,800)
Leasehold improvements	–	(275)	–	(275)
Total accumulated depreciation	–	(10,075)	–	(10,075)
Total capital assets, net	\$ –	\$ 94,687	\$ –	\$ 94,687

NOTE 5 – LEASES

The authority entered into a noncancelable operating lease for office space for October 1, 2006 through October 1, 2011.

Future minimum lease payments due under the noncancelable office operating lease will be:

Fiscal Year End	
2009	\$ 51,441
2010	53,103
2011	54,864
2012	13,817
Total future minimum lease payments	<u>\$173,225</u>

The total rental expense included in the financials for the years ended June 30, 2008 and 2007, was \$51,878 and \$39,581, respectively.

NOTES TO THE FINANCIAL STATEMENTS, CONTINUED

NOTE 6 – NOTE RECEIVABLE

In February 2007, the authority entered into an agreement with a bioscience company to assist in its performance of bioscience research, development and commercialization, and creation of new jobs. The agreement provides for a maximum advance of \$2 million. As of June 30, 2008, \$2,090,382 was outstanding under the agreement, which included \$90,382 of accrued interest. The note includes an interest rate of 6%, is secured by all equipment of the company, and is payable in full in February 2012, less any “employee credits.” These credits allow for the amounts owed under the agreement to be reduced by \$250,000 for every 25 new full-time equivalent positions created in Kansas, after maintenance of such positions for a consecutive 365-day period. As of June 30, 2008, no employee credits had been earned by the bioscience company.

NOTE 7 – COMMITMENTS

The KBA invests its resources through various programs as outlined in Note 1. The terms of each funded project vary, but generally the investees are required to meet milestones to receive funding. Such milestones may include adding a certain number of employees in Kansas, recruiting students or researchers into bioscience studies, and investing in new bioscience equipment or facility expansion, among others. Therefore, projects approved by the authority do not become obligations until the milestones are met and payment becomes probable. As of June 30, 2008, the authority had \$37,702,968 of outstanding, approved commitments for various projects. Subsequent to June 30, 2008, an additional \$13,750,000 was committed by the authority for additional projects.

Each funded project has different terms and arrangements for funding. These projects have payment terms attached to milestones that cover periods from one to ten years. Management evaluates and projects future cash flow payments based on information about the status of each program. As of June 30, 2008, it is estimated that approximately \$17,200,000 will be paid out in fiscal 2009 for the projects outstanding as of June 30, 2008, and those approved subsequent to year-end through September 30, 2008. This projection does not include payments on additional projects that may be funded in fiscal 2009 and is subject to change based on the achievement of milestones. Actual future cash flows could differ from the estimates as of June 30, 2008.

NOTE 8 – RETIREMENT PLAN

During fiscal 2008, the KBA implemented a 401(a) plan (Plan) which matches the employee’s deferral up to 4% of the employee’s wages and contributes an additional 4% of wages as an elective contribution. Employer contributions to the Plan were \$27,382 for the year ended June 30, 2008. The KBA also offers a 457(b) plan which allows for employees to defer wages up to the amounts allowed by the IRS.

NOTE 9 – LAND HELD FOR DEVELOPMENT

The city of Olathe conveyed approximately 54 acres of land to the KBA to create the Kansas Bioscience Park. The purpose of the park is to assist in developing specialized infrastructure to facilitate the growth and expansion of bioscience companies. A benefit district has been created by the city of Olathe to build the infrastructure at the park, and construction commenced in August 2008.

SCHEDULE OF COMMITMENTS

June 30, 2008

Project	Date Approved	Funds Originally Committed	Commitments Released	Funds Currently Committed	Total Paid to Date at 6/30/08	Total Remaining To be Paid
Prescription Solutions	7/11/2005	150,000	150,000	—	—	—
Heartland BioEnterprise	1/5/2006	200,000	—	200,000	6,062	193,938
KansasBio	1/5/2006	100,000	—	100,000	100,000	—
Hospira, Inc	4/11/2006	200,000	—	200,000	90,000	110,000
Quintiles	4/11/2006	3,500,000	—	3,500,000	2,500,000	1,000,000
JACAM Chemicals	4/11/2006	500,000	—	500,000	345,000	155,000
IdentiGEN	4/11/2006	125,000	—	125,000	50,000	75,000
	FY 2006 Totals	\$ 4,775,000	\$ 150,000	\$ 4,625,000	\$ 3,091,062	\$ 1,533,938
City of Manhattan (NISTAC)	7/13/2006	1,000,000	—	1,000,000	200,000	800,000
CritiTech	7/13/2006	48,700	—	48,700	48,700	—
Kansas City Area Development Council	7/13/2006	41,200	—	41,200	41,200	—
Kansas City Area Life Sciences Institute	7/13/2006	10,000	—	10,000	10,000	—
MGP Ingredients	7/13/2006	40,000	—	40,000	5,000	35,000
Nutri-Shield	7/13/2006	40,000	—	40,000	27,699	12,301
Sunflower Bioenergy Phase 1	7/13/2006	13,000	—	13,000	13,000	—
Wet-Lab Planning & Architecture	7/13/2006	150,000	66,509	83,491	83,491	—
KUMC Wet-Lab Upgrade	7/13/2006	100,000	—	100,000	100,000	—
Topeka Chamber of Commerce	7/13/2006	13,388	—	13,388	13,388	—
Caravan Ingredients	7/13/2006	1,000,000	30,000	970,000	120,000	850,000
OneImmune	10/12/2006	2,500,000	—	2,500,000	2,319,864	180,136
Junction City, KS (Ventria)	10/12/2006	1,000,000	—	1,000,000	—	1,000,000
NBAF Phase I	1/9/2007	250,000	—	250,000	250,000	—
Kansas Bioscience Park/ K-State Campus	1/9/2007	7,600,000	—	7,600,000	34,728	7,565,272
KansasBio	1/9/2007	75,000	—	75,000	75,000	—
Hospira, Inc	1/9/2007	64,000	—	64,000	—	64,000
Sunflower Bioenergy Phase 2	1/9/2007	500,000	—	500,000	150,000	350,000
Edenspace Systems	3/13/2007	200,000	—	200,000	—	200,000
Kansas Bioscience Fund	5/25/2007	100,000	—	100,000	—	100,000
Centers of Innovation – KCBID	5/25/2007	200,000	—	200,000	66,667	133,333
Centers of Innovation – KBICDD	5/25/2007	180,000	—	180,000	120,000	60,000
Centers of Innovation – Plant Design	5/25/2007	200,000	—	200,000	133,334	66,666
Centers of Innovation – Other	5/25/2007	420,000	—	420,000	—	420,000
Heartland BioVentures	5/25/2007	4,600,000	—	4,600,000	—	4,600,000
	FY 2007 Totals	\$20,345,288	\$ 96,509	\$20,248,779	\$ 3,812,071	\$16,436,708

SCHEDULE OF COMMITMENTS, CONTINUED

June 30, 2008

Project	Date Approved	Funds Originally Committed	Commitments Released	Funds Currently Committed	Total Paid to Date at 6/30/08	Total Remaining To be Paid
OsteoGeneX	7/10/2007	130,000	—	130,000	130,000	—
ABADRL/City of Manhattan	7/10/2007	1,500,000	1,500,000	—	—	—
Innovia Medical	7/10/2007	650,000	—	650,000	650,000	—
City of Emporia, KS (REG)	7/10/2007	300,000	—	300,000	—	300,000
Fort Dodge Animal Health	7/10/2007	3,500,000	—	3,500,000	—	3,500,000
KC BioMediX	7/10/2007	150,000	—	150,000	150,000	—
CritiTech	9/28/2007	264,048	—	264,048	264,048	—
Kansas Environmental Management Associates	9/28/2007	312,500	—	312,500	187,210	125,290
ThermoFisher Remel	9/28/2007	1,250,000	—	1,250,000	250,000	1,000,000
NBAF Phase II	9/28/2007	440,000	—	440,000	292,653	147,347
Collaborative Biosecurity Research Initiative	9/28/2007	2,500,000	—	2,500,000	—	2,500,000
KansasBio	9/28/2007	100,000	—	100,000	100,000	—
Deciphera - East Hills Incubator	11/26/2007	3,500,000	3,500,000	—	—	—
Edenspace USDA SBIR-1	11/26/2007	40,000	—	40,000	20,000	20,000
Edenspace DOE SBIR-1	11/26/2007	50,000	—	50,000	25,000	25,000
Eminent Scholar – University of Kansas	1/16/2008	5,000,000	—	5,000,000	1,000,000	4,000,000
Eminent Scholar – Kansas State University	1/16/2008	2,055,000	—	2,055,000	612,500	1,442,500
MATRIC	1/16/2008	2,000,000	2,000,000	—	—	—
Pinnacle Technology	1/16/2008	375,000	—	375,000	115,000	260,000
Biosecurity Research Institute	2/26/2008	1,548,000	—	1,548,000	1,548,000	—
KU Breidenthal KUMCRI	4/8/2008	2,000,000	—	2,000,000	2,000,000	—
Eminent Scholar – Wichita State	4/8/2008	911,954	—	911,954	182,391	729,563
OsteoGeneX NIH SBIR Phase II	6/5/2008	375,000	—	375,000	—	375,000
Collaborative Cancer Research Initiative	6/5/2008	2,500,000	—	2,500,000	—	2,500,000
Ventria Phase I Expansion	6/5/2008	3,750,000	—	3,750,000	3,750,000	—
Immunogenetix Therapeutics, Inc. (IGX)	6/5/2008	420,000	—	420,000	—	420,000
Vince and Associates, LLC	6/5/2008	200,000	—	200,000	—	200,000
TVAX Inc BTIIP	6/5/2008	187,622	—	187,622	—	187,622
	FY 2008 Totals	\$36,009,124	\$ 7,000,000	\$29,009,124	\$ 9,276,802	\$19,732,322
	Totals	\$61,129,412	\$ 7,246,509	\$53,882,903	\$16,179,935	\$37,702,968

First Proof: 11/7/08 Second: 12/16/08

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*



To the Board of Directors
Kansas Bioscience Authority
Olathe, Kansas

We have audited the financial statements of the Kansas Bioscience Authority (Authority), a Component Unit of the State of Kansas, as of and for the year ended June 30, 2008 and have issued our report thereon dated October 6, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with these provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, management, and others within the entity, and is not intended to be, and should not be, used by anyone other than those specified parties.

Allen, Gibbs & Houlik, L.C.
Certified Public Accountants
October 6, 2008
Wichita, Kansas

